



VIRGINIA STATE LOTTERY DEPARTMENT

REPORT ON AUDIT FOR THE YEAR ENDED JUNE 30, 2013

AUDIT SUMMARY

Our audit of the Virginia State Lottery Department (Lottery) for the year ended June 30, 2013, found:

- the financial statements are presented fairly, in all material respects;
- internal control findings requiring management's attention; however, we do not consider them to be material weaknesses; and
- instances of noncompliance or other matters required to be reported under Government Auditing Standards.
- Lottery did take adequate corrective action with respect to audit findings reported in the prior year that are not repeated in this report.

We have audited the basic financial statements of the Virginia State Lottery Department (Lottery) as of and for the year ended June 30, 2013, and issued our report thereon, dated August 15, 2013. Our report is included in the Lottery's Annual Report that it anticipates releasing on or around October 2013.

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INTERNAL CONTROL AND COMPLIANCE FINDINGS AND RECOMMENDATIONS

Periodically Test IT Infrastructure Device

Lottery does not periodically test an Information Technology (IT) infrastructure device that serves as one of many protection layers into Lottery's network. Periodic tests help organizations identify weaknesses in network protection mechanisms that may go undetected as devices are reconfigured over time to meet business needs.

Since our recommendation includes descriptions of security mechanisms, we have communicated the details of this weakness to Lottery's management in a separate document marked Freedom of Information Act Exempt under Section 2.2-3705.2 of the Code of Virginia.

We recommend that Lottery continue working with its vendors to identify a product that can automate this process to the best extent possible. Until such a product is identified and implemented, we recommend that Lottery continue manual reviews and monitoring of this device as required by the Commonwealth's information security standard, SEC501-07.

Improve Server Security

Lottery did not implement certain minimum information security controls required by the Commonwealth's information security standard, SEC501-07.1, on an internal server that processes sensitive and confidential data. The minimum controls outlined in the standard help strengthen the protection layers that surround sensitive data.

Since our recommendations include descriptions of security mechanisms, we have communicated the details of this weakness to Lottery management in a separate document marked Freedom of Information Act Exempts under Section 2.2-3705.2 of the Code of Virginia.

During the course of our audit, we recommended, and the Lottery implemented, those controls outlined in the Commonwealth's information security standard on systems that process sensitive and confidential data.

EFFICIENCY OBSERVATION

Improve Automation of Reconciliation Processes

Lottery is not utilizing electronic data available for use in reconciliations between the outsourced gaming system and their internal financial system, including outsourced system calculations, causing them to perform additional data entry and manual recalculations. The volume of information being manually entered and the time spent entering data and recalculating amounts is significant, diverting valuable man hours that could be better spent on revenue generating activities and increasing the risk for human error.

We recommend Lottery follow through with their Information Technology Strategic Road Map and implement automated methods of completing their reconciliation processes. Lottery should explore methods of obtaining the data from the outsourced gaming system by using internal tools or writing queries in Business Objects. We also recommend Lottery rely on the outsourced gaming system's calculations of remaining prize liability, advanced on-line sales liability, and sales and cashing commissions, performing recalculations to validate daily system functionality on a sample basis. By using the automated functionality available, Lottery will reduce the risk of human error while increasing the productivity of its staff.



Commonwealth of Virginia

Auditor of Public Accounts

Martha S. Mavredes, CPA
Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

August 15, 2013

The Honorable Robert F. McDonnell
Governor of Virginia

The Honorable John M. O'Bannon, III
Chairman, Joint Legislative Audit
And Review Commission

Members
Virginia State Lottery Board

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, the basic financial statements of the **Virginia State Lottery Department** (Lottery) as of and for the year ended June 30, 2013, and have issued our report thereon dated August 15, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Lottery's internal control over financial reporting to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Lottery's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Lottery's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, material weaknesses may exist that have not been

identified. We did identify certain deficiencies in internal control over financial reporting entitled “Periodically Test IT Infrastructure Device” and “Improve Server Security,” which are described in the section titled “Internal Control and Compliance Findings and Recommendations,” that we consider to be significant deficiencies in internal control over financial reporting.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Lottery’s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under Government Auditing Standards. Instances of noncompliance and other matters, entitled “Periodically Test IT Infrastructure Device” and “Improve Server Security,” are described in the section titled “Internal Control and Compliance Findings and Recommendations.”

The Lottery’s response to the findings identified in our audit is included in the section titled “Agency Response.” We did not audit the Lottery’s response and, accordingly, we express no opinion on it.

Status of Prior Findings

The Lottery has not taken adequate corrective action with respect to the previously reported finding “Periodically Test IT Infrastructure Device.” Accordingly, we included this finding in the section entitled “Internal Control and Compliance Findings and Recommendations.” The Lottery has taken adequate corrective action with respect to audit findings reported in the prior year that are not repeated in this report.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity’s internal control or on compliance. This report is an integral part of an audit performed in accordance with Government Audit Standards in considering the entity’s internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

We discussed this report with management at an exit conference held on September 13, 2013.

AUDITOR OF PUBLIC ACCOUNTS

AVG/alh



September 24, 2013

Ms. Martha S. Mavredes, CPA
Auditor of Public Accounts
101 North 14th Street
Richmond, Virginia 23219

Dear Ms. Mavredes:

Attached are the Virginia Lottery's responses to the Auditor of Public Accounts Report on Audit for the year ending June 30, 2013. As always, we appreciate the professionalism of your staff and the open dialogue that we employ with you. In particular, we appreciate the unqualified opinion on the accuracy and fairness of our financial statements for Fiscal Year 2013. The following are our responses to the issues contained in the internal control report:

Periodically Test IT Infrastructure Device

The Lottery recognizes the importance of firewalls and proper firewall management. We have faced challenges in obtaining a suitable automated solution for firewall rule and configuration reviews. As a result of these difficulties, we supplemented the Lottery's strong firewall rule change request process by conducting vulnerability scans every 90 days, in accordance with VITA policy. Additionally, we conduct semiannual manual reviews of firewall rules and configurations to supplement our overall firewall management. We continue to pursue automated technological solutions that are compatible with the Lottery's firewall hardware to automate the function and permit more frequent configuration and rule reviews; in the interim, until such a solution is available, we will continue with our current manual processes for firewall management.

Improve Server Security

As noted in your report, this issue is fully resolved.

Improve Automation of Reconciliation Processes

The Lottery values efficiency in operations, and the accuracy and integrity of data. The particular reconciliation in question is a critical function, but requires less than 5% of an FTE to maintain. Efficiencies are built into current reconciliation processes, such as automatic calculations and the automated population of forwarded balances; however, further improvements in this process have been previously identified and included on our overall technology plan.

The Lottery conducts billions of transactions each year, all of which accumulate and ultimately comprise the results presented in the financial statements. We believe that adequate internal controls and the prioritization of activities is our responsibility to ensure the accuracy of our financial information; these reconciliation processes support those objectives. While it may seem unnecessary or inefficient to perform recalculations, these automated checks and balances have helped to identify isolated system processing errors, missing file transaction interfaces, and other issues. Without the full effort of the reconciliations, these problems may have gone undetected and resulted in incorrect financial data.

Certainly, it is our intention to improve on many processes when higher priority projects are completed, and after the internal data warehouse is available as a resource and tool. Technology projects are evaluated on a set of specific criteria, including efficiencies and/or revenue generating potential. Because our business is generating profits, often revenue generating projects receive the necessary prioritization over operating efficiencies.

Because one of the issues contained in the report is fully resolved, and the other two are already scheduled according to established protocol, this will be the only action plan filed for the fiscal year.

Sincerely,



Paula I. Otto

c: David VonMoll, Comptroller

VIRGINIA STATE LOTTERY DEPARTMENT

BOARD MEMBERS

As of June 30, 2013

Albert H. Poole
Chairman

Cynthia D. Lawrence

Kevin D. Smith

Robert Howard

AGENCY OFFICIALS

Paula I. Otto
Executive Director